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C O N F I D E N T I A L SECTION 01 OF 03 KABUL 002548

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TAGS: [TAGS](#)  
SUBJECT: AFGHANISTAN - PRIVATE READOUT IMF MISSION  
CONCLUSIONS FROM JULY VISIT

REF: KABUL 1746 AND SECSTATE 82558

Classified By: Classified By: Ambassador William Wood for reasons  
1.4(b)&(d).

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readout from the IMF Mission to Afghanistan. It is for  
internal USG use only. Please protect accordingly.

#### SUMMARY

¶1. (C/NF) The recent IMF mission focused on revenue targets, ad hoc tariff decisions, banking supervision, and progress on the Afghanistan National Development Strategy (ANDS). The IMF continues to raise concerns about increased political interference in tax and customs collections. While the Finance Ministry slightly exceeded its annual revenue targets in Afghan Fiscal Year 1385 (March 21-March 20) taking in \$575 million, it was behind on its 1386 first quarter target by 8-9 percent. The quarterly targets are not as significant as the annual target (\$715 million for 1386), but this shortfall does signal the importance of GOA carefully managing revenue collection and developing a simple, transparent tax and tariff regime that is easier to implement and enforce.

¶2. (C/NF) The IMF mission visited Kabul in July to conduct a staff review of the Government of Afghanistan's (GOA) compliance with the performance targets and structural benchmarks in the Poverty Reduction and Growth Facility (PRGF) arrangement. This was in advance of the third full review of the PRGF in October-November 2007.

END SUMMARY.

ON-GOING REVENUE ISSUES

¶3. (C/NF) The IMF spent substantial time discussing

concerns about the GOA's ad hoc tariff decisions. They have asked GOA to reverse the 40 percent tariff on bottled drinks to its previous 20 percent and to remove the discretionary application of the 1 percent tariff on certain imported raw materials and intermediate goods. This protectionist response could lead to increased smuggling, possibly reducing GOA revenues. An agreement was reached between the IMF and GOA to reduce the bottled drinks tariff to 20 percent within 18 months and to develop a list of products that would receive the 1 percent tariff, thus eliminating its discretionary application.

¶4. (C/NF) However, the IMF said there were clear signals in their meeting with President Karzai that more ad hoc protectionist tariffs will be introduced. According to the IMF mission chief, Finance Minister Ahadi argued against such tariff measures in the meeting with the President but Dr. Nadiri, the President's Senior Economic Advisor, argued for them. It seems the President has been swayed toward the protectionist position. Based upon the President's previous decision to support the two ad hoc tariff measures and his comments in that meeting, this is going to be an on-going struggle for the IMF and international donors who do not support such protectionist measures. GOA's rationale for such decisions is the need to help domestic producers, but this is more of a simple, quick fix for such producers who would likely benefit more from improvements in the overall investment climate (e.g., provision of reliable and inexpensive electricity).

¶5. (C/NF) There remains continued concern about political influences in tax policy and collection, and pressures from outside the Ministry of Finance (MOF) by investigative

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agencies that have led to a substantial loss of staff from MOF's Large Taxpayers Office (LTO). The office is down to 12 staff from 35. The deputy director of the LTO is now back at work (after having been suspended for several months) and MOF is moving staff from other divisions to help with revenue collection, but two on-going investigations continue (one by the Attorney General's Office and the other by the General Administration Against Corruption, the GIACC).

¶6. (C/NF) The IMF mission chief spoke frankly with Finance Minister Ahadi about the overall situation. Having come from his first meeting with the President, the mission chief expressed a greater understanding of range of opinions on economic and tax policy. The IMF mission chief also raised these concerns with Ambassador Wood in a separate bilateral meeting.

#### FISCAL SUSTAINABILITY CHALLENGES

¶7. (C/NF) Of course, the revenue situation impacts the ability of GOA to meet its international commitment to cover its recurrent expenses. GOA has already acknowledged that it expects to be delayed in meeting this commitment to cover 58% of recurrent expenses with revenue by two years until 2012-2013, which will be compounded if revenue problems continue at the same time as expenditure pressures increase. (NOTE: On this IMF trip, the GOA did not raise new expenditures pressures with the IMF, but they are expected to do so around the time of the GOA's mid-fiscal year budget review in October when the mission is next in Kabul.)

#### BANKING SUPERVISION

¶8. (C/NF) The IMF view is that banking supervision has not kept up with the growth of the commercial banking sector. In meetings with the Da Afghanistan Bank's (DaB) First Deputy Governor, the IMF was advised that DaB plans to increase staff on bank supervision and will prepare a plan to address gaps in the area.

ANDS DEVELOPMENT

¶9. (C/NF) The mission was pleased that MOF plans to take the lead on the costing of the budget impact of sector strategies in order to estimate the costs of the overall ANDS. Consistent with the development of Poverty Reduction Strategy Papers in other countries, the IMF has advised the Ministry that a partial costing of the ANDS covering major expenditures will be acceptable in the short term.

HIPC INITIATIVE PROGRESS

¶10. (SBU/NF) In early July, the World Bank and IMF Boards approved the HIPC triggers for Afghanistan and granted HIPC Decision Point status, making the country eligible for multilateral debt relief. A partially costed ANDS has to be successfully implemented for 1 year to reach HIPC Completion Point and GOA has to continue to achieve the reforms under the IMF PRGF and achieve all HIPC triggers or benchmarks. GOA hopes to achieve Completion Point around March 2009.

¶11. (SBU/NF) Under the Paris Club agreement, GOA has signed bilateral debt agreements with the U.S. and Germany and is expected to sign a bilateral agreement with Russia this month.

COMMENT

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¶12. (C) Post will continue to closely follow the revenue situation, and encourage GOA at all levels that such ad hoc tariff decisions are not advisable. Per SECSTATE 82558, Embassy staff has raised these tariff concerns with officials from the Ministries of Finance and Commerce.

END COMMENT.

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